Minutes of Teleconference of Task Force B
(July 10, 1997 at 2:00pm, EDT)

I. Identified parties present:

Jack Harper, Co-Leader	**Roy Crawford, Co-Leader**
Harold Aldinger	**Mike Finger**
René Blocker	**Jeff Friedman**
Alan Friedman (Facilitator)	
Jennifer Hayes	**Margaret Kent**
Steve Krenkel	**Valerie Montague**
Paull Mines (Reporter)	**Russ Uzes**
W. Val Oveson	
Chuck Redfern	
John Theis	
Brian Toman	

Ed. Note: **These minutes do not disclose the identity of specific individuals that prepared individual presentations to start the discussions in specific areas of interest to the Task Force. In fact, the minutes identify no one with respect to recorded discussions. I have adopted this style, notwithstanding the special effort played by others to bring meaningful conversation to the table that should in normal circumstances be recognized, because the underlying assumption of the participants is that no participant should be precluded from free expression. Non-attribution allows all to state their views frankly, because it lessens the threat of being tagged with their own comments that were made in the course of the intended, free-flowing examinations undertaken by the Public Participation Working Groups.**

II. No public comments were made.

III. At the prior meeting of the Task Force in Dallas, specific sub-topics of interest to the Task Force were assigned to certain individuals for the initial presentation. The assigned topics were—

- **Holding companies;**
- **Pass-through entities with specific emphasis on partnerships;**
- **Instant unity;**
- **Unity of ownership; and**
- **Use of presumptions.**

The discussion thereafter preceded with the understanding that the Task Force was commissioned to report its progress in Whitefish in early August and that it was not incumbent upon the Task Force to reach final resolution of its assigned issues by that time.

IV. Use of presumptions: Five areas where the draft business/non-business income regulation uses presumptions or where the use of (additional) presumptions might be considered were identified to include:

- *Presumption favoring business income*. **There is a presumption in favor of finding business income that may be overcome if the taxpayer establishes the contrary understanding by clear and cogent evidence.** *See* **lines 50-54; 323-24.**

- *Expanded transactional test*. **There is a statement that it is sufficient to classify a transaction or activity as being in the regular course of a trade or business, if it is reasonable to conclude that transactions of that type are customary in the kind of trade or business being conducted or are within the scope of what that kind of trade or business does.** *See* **lines 69-74.**

- *Idle property presumption*. **A presumption could be added to the draft regulation that property that lies idle for a set period of time is presumptively a nonbusiness asset.** *Compare* **MTC Reg. IV.1.(c)(1),** *example (vii)* **(lines 212-221) and MTC Reg. IV.1.(c).(2),** *example (v)* **(lines 248-257).**

- *Conversion of property from identifiable event*. **A presumption could be added to the draft regulation that following an "identifiable event" property could convert from being nonbusiness property to business property and from business property to nonbusiness property.**

- *Presumption flowing from deductions and inclusion in property factor*. **There is a statement that the taking of a deduction with respect to property for determining apportionable income or the inclusion of the property in the property factor for determining the apportionment formula gives rise to a presumption that the property is business property.** *See* **lines 115-119.**

  Tentative consensus developed. The Task Force reached a tentative consensus on the *presumption favoring business income*, **including the part that referenced clear and cogent proof as necessary to overcome the presumption,** *provided*, **the presumption operated in both directions. The viewpoints that were considered in the development of this tentative consensus included—**

  1. *Promotes uniform treatment*. **The rule promotes uniform treatment in an area where uniform treatment is required, because it is undesirable to have states classifying income differently.**

  2. *California's experience positive*. **California has a similar presumption and the experience with the presumption in that State has generally been positive.**

  3. *Supreme Court endorses standard of proof*. **The U.S. Supreme Court has clearly and repeatedly enunciated the clear and cogent evidence standard of proof for overcoming apportionable income classifications.**

  4. *Presumption not clearly stated in UDITPA*. **The presumption is not clearly stated in UDITPA [Ed. Note: although the statute does contemplate first determining whether the income is business income before concluding the income is nonbusiness.**

  5. *Some say presumption approaches full apportionability*. **The presumption has been identified by some as approaching full apportionability, something not authorized by the U. S. Supreme Court's decisions. This contention is, however, argumentative and does not clearly reflect the limited application of the presumption.**

  6. *Clear and cogent evidence standard of proof reflects deference to state court findings*. **The U.S. Supreme Court embraces the clear and cogent evidence**

standard of proof as a matter of deference to state court findings and state court's themselves do not adhere to the standard.

7. *Focus on state tax administration, not court standards.* **The presumption and the burden of proof standard should be viewed from the perspective of state tax administration and not court litigation. The clear and cogent evidence standard is somewhere between proof by the preponderance of the evidence and proof beyond a reasonable doubt.**

8. *Difficult to abandon clear and cogent evidence standard.* **Given the U.S. Supreme Court's repeated enunciation of the clear and cogent evidence standard States are unlikely to want to abandon the standard.**

9. *States in the PPWG process should consider desirability of middle ground.* **Without commenting on whether States should consider abandoning the clear and cogent evidence standard, PPWG process assumes States will have an open mind about examining issues for determining whether there is an acceptable compromise available even if States are supported in their position by established court doctrine.**

10. *Presumption should operate both ways.* **If the presumption operates in both directions, then the presumption is useful.**

No consensus was reached regarding the statement that a transaction or activity is in the regular course of a trade or business, if it is customary in the kind of trade or business being conducted or within the scope of what that kind of trade or business does. One participant agreed to develop possible refining language to ensure that the statement was no more than an evidentiary rule and not a presumption. The viewpoints expressed included—

1. *Creates artificial analysis.* **Determining what the trade or business actually is would be a difficult issue that needs to be met first before you can even begin to consider what is customary in that trade or business. The statement unnecessarily increases the complexity of disputes over the proper classification of business income.**

2. *Analog available under IRC.* **The "ordinary and necessary" concept for business expenses has to face an analogous issue and that has been resolved in favor of recognizing what is customary in the trade or business and not the specific business of the taxpayer.**

3. *Statement expands transactional test.* **The statement expands the transactional test to accommodate circumstances where the functional test is not recognized—the statement mitigates the harsh results of not having a functional test. If a clear functional test is recognized, there is less need for keeping the statement.**

4. *Other task force saw some potential for reducing complexity.* **Another task force that discussed this issue saw some potential for reducing complexity, since examination of the historical activities of a particular business that are outside the audit period is more daunting that coming to some understanding of what the customary transactions are of a trade or business on a generally abstract level.**

5. *California experience.* **California's experience is that there would be a heavy burden in understanding what the trade or business was of a particular taxpayer.** *A.M. Castle***'s reference to the special industry manual was more of an evidentiary ruling than a presumption.**

The task force noted the presumptions for idle property and conversion from one character to another arising from an identifiable event. The current proposal does not contain anything specific in these areas. The property factor suggestion of a five year rule for idle property was lauded as being quite workable. *See* **MTC Reg. IV.1.(c).(1),** *example (vii)* **(lines 212-221) and MTC Reg. IV.1.(c).(2),** *example (v)* **(lines 248-257). One participant indicated that the issue often arises in the context of property that cannot be disposed of, like environmentally damage property or property whose location or substantial improvements have become obsolete. The occurrence of both the idle property and identifiable event circumstances are important and the Task Force deferred to later a fuller discussion of the applicable principles. Certainly the concept of when newly acquired property becomes business property and the related concept of availability for use will need to be examined.**

A participant indicated that she is still examining the presumption flowing from deductions and inclusion in property factor. That this presumption appearing at line 115 has no time limit was noteworthy to this participant. Another participant noted the short memorandum penned by John Warren for another Task Force on the possible need for consistency between the property factor and the business income rules. [Ed. Note: The Warren memorandum will be distributed to all Task Forces so it can be reviewed for some illumination on this subject.]

V. Instant unity: A participant led the discussion of instant unity. The tentative recommendation of the participant to the group, not yet adopted, was that there be a presumption that a newly acquired company would not be understood to be a part of the unitary business of the acquiring company for the short reporting period (from date of acquisition to date immediately preceding the group's common tax reporting period). The presumption could be overcome by either the taxpayer or the State upon proof by clear and cogent evidence. The presumption would not apply to newly formed affiliates for which it can reasonably be understood that instant unity is quite possible. The presumption should be just the opposite for newly formed companies: newly formed companies are presumed to be instantly unitary, unless that presumption is overcome by either the taxpayer or the State by proof of clear and cogent evidence. The viewpoints expressed on this recommendation included—

1. *Binding elections.* **Binding elections for instant unity are unsatisfactory, because they often lead to results that conflict with the basic understanding of what constitutes a unitary business.**
2. *Transitional issue.* **Does the proof of a unitary relationship sufficient to overcome the presumption against unitary in the short reporting period have to be concerned with the date the unitary relationship began in the short reporting period? Some said no, others expressed concern over a whipsaw. The whipsaw could arise according to these observers because a flat rule of unitary for the entire short reporting period if unitary at the end of the short reporting period would allow the taxpayer to benefit from the rule when beneficial and challenge the rule on gross disproportionality when detrimental.**
3. *Is silence golden?* **Some wanted to leave the transitional issue open; others stated that the issue should not be finessed by silence. Some noted that the rule favored exclusion and the overcoming of the exclusion by clear and cogent evidence could reasonably be adopted as a fair result that proof of unitary for any period gave rise to the conclusion that the relationship was unitary for the entire period.**

4. *Memorandum attached.* **Steve Krenkel's memorandum with attached cases on the issue of instant unity (prepared after the Task Force meeting) is attached.**

VI. **Holding companies: A participant led this discussion. It was noted that the holding company issue here presented is the one that arises because a corporation holds stock to one or more operating subsidiaries. The issue does not concern passive investment companies, like Delaware holding companies. The tentative recommendation to the group, not yet adopted, was that the MTC regulation should adopt the** *PBS* **approach of the California BOE that is reflected in legal rulings 95-7 and 95-8 of the California Franchise Tax Board. The viewpoints expressed with respect to this possible approach included—**

1. *Unresolved issue when more than one unitary business being conducted.* **The issue of how to effect the combination of a holding company when the holding company acts with respect to two or more different unitary businesses was raised but unresolved. A spark of intensity was raised with respect to intercompany transactions involving the holding company that is unitary with two or more separate lines. No clear position was established among the participants as to how the elimination rule should be administered in these circumstances. Two views were expressed: unitary is unitary and the need to apportion the elimination to reflect the division of the holding company's affiliation with the different unitary lines of business.**

2. *Allocate on facts and circumstances basis***. It seems better to retain a facts and circumstances approach rather than develop hard and fast rules for the two or more unitary businesses situation that would inevitably be more rigid. The regulation at II.D., lines 57-66, reflects a facts and circumstance approach.**

3. *Contentious interest***. The contentious issue of interest is always potentially present when a facts and circumstances approach is taken. One approach traces money; another approach views money as fungible and avoids tracing. Those responsible for apportionment rules need to wrestle with the interest issue and not this task force.**

VII. **Unity of ownership: The California statute on unity of ownership was referenced.** *See* **attached § 25105. A participant contrasted the California approach by suggesting a simpler approach: Unity of ownership exists is there is direct or indirect ownership of more than 50% of the voting stock. Control under this proposal is irrelevant, the justification being that unity of ownership contributes the element of fairness to income attribution that flows from combination. Control adds nothing to this determination. There was no substantive discussion on this proposal, leaving by default its consideration to another meeting.**

VIII. **Pass-through entities: A participant recommended consideration of California's approach to the apportionment of income of a unitary partnership. The task force did not exhibit a lot of enthusiasm for undertaking a comprehensive examination of the unitary business principle as applied to all types of pass-through entities. One participant exclaimed that the task force wanted to complete its work in this millenium.**

IX. **Future Meeting. The next meeting of the task force is set for July 24, 1997, at 2:00pm, Eastern Daylight Time. Participants need to call (703) 736-7307 and ask to participate in the Multistate Tax Commission call moderated by Paull Mines.**

In preparation for this next teleconference, participants will reflect on the issues that have been discussed with a view to determining at the next task force whether any areas under discussion are open to consensus agreement. For those areas for which consensus is not possible, the participants should be prepared to state concisely the reason for not reaching consensus.